RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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April 8, 1987 **LETTER 962**

WAITING FOR PROOF: In the last Letter I said that we probably should welcome any market decline. Why welcome a decline? Because on the basis of our new policy of demanding that this bull market "prove itself," each market decline provides us with a new opportunity to RE-CHECK the direction of the primary trend.

All right, here we are. Last week (week ending April 3) we experienced a short but violent market decline. With that decline came our first real opportunity in 1987 to put the market to the test, to make it PROVE TO US THAT IT'S STILL A BULL MARKET. The test? The two D-J Averages would have to climb to new bull market highs — Transports above their March 6 high of 958.21, Industrials above their 2379.59 high of March 26 (see page 1 chart).

A rally by BOTH averages above those highs would re-confirm the primary bull market -- in which case substantially higher prices might be expected. Conversely, a refusal by one or both Averages to better the highs could mark the beginning of trouble.

On April 3 the Dow, in its biggest one-day surge (69.89 points) in history, bettered its March 26 high to close at a record 2390.34. The Transports, up over 22 points for the day, failed by 7 points to confirm. However, it is notable that both the NYSE and the S&P Transportation indices did confirm, both rising to new record highs. Therefore, it would seem only a matter of time until the D-J Transports follow. But as of this writing the D-J Transports have not hurdled the 958.21 peak. IT IS VITALLY IMPORTANT THAT THEY DO SO. If they do, we will have a newly re-confirmed bull market.

Question: What about the lagging Utility Average and the other major indices?

Answer: Actually, two confirmatory items that I do monitor carefully are the D-J Utility Average and the daily A-D ratio. The Utility Average topped out way back on January 22 at 227.83. The A-D ratio hit a peak of minus 3.20 (see page 2 chart) on March 23. It will tell us a lot about this market if these two indicators make new bull market highs -- or fail to advance to new highs. Neither the Utilities nor the A-D play any part in Dow Theory, but I nevertheless attach a good deal of importance to their overall performances.

Question: Russell, why did you take last week's market break seriously? There have been dozens of market breaks since this bull market began in late-1974.

Answer: From now on I will take ALL market breaks seriously because (1) they will be occurring within the THIRD (psychological) phase of the bull market. This is the speculative phase, the overvaluation phase, and it is also the phase where ultimately the next primary bear market will begin. And (2) I will take all future market breaks seriously because they will be occurring within the context of an exponential rise in the Dow (see last Letter for more on exponential rises).

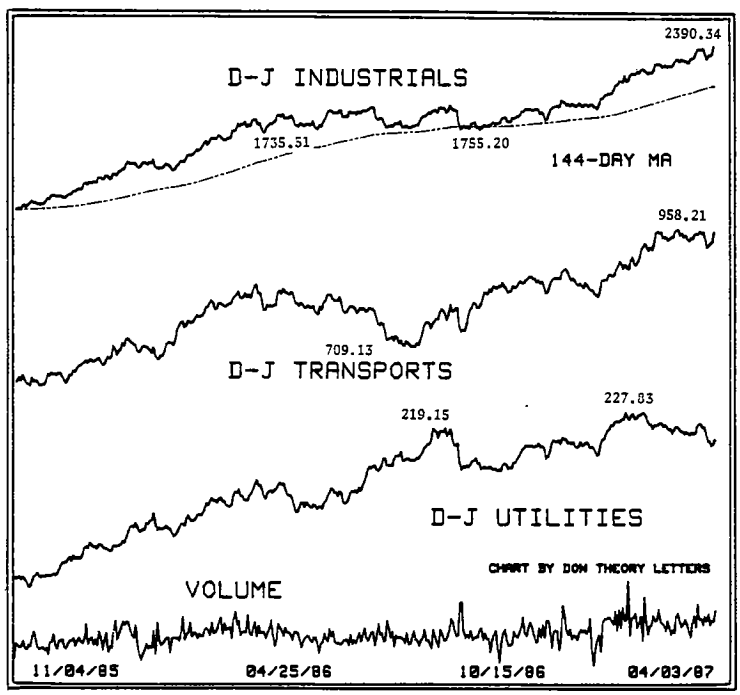
Question: This market continues to look like a tiger on the upside. Are you worried about being overly cautious here?

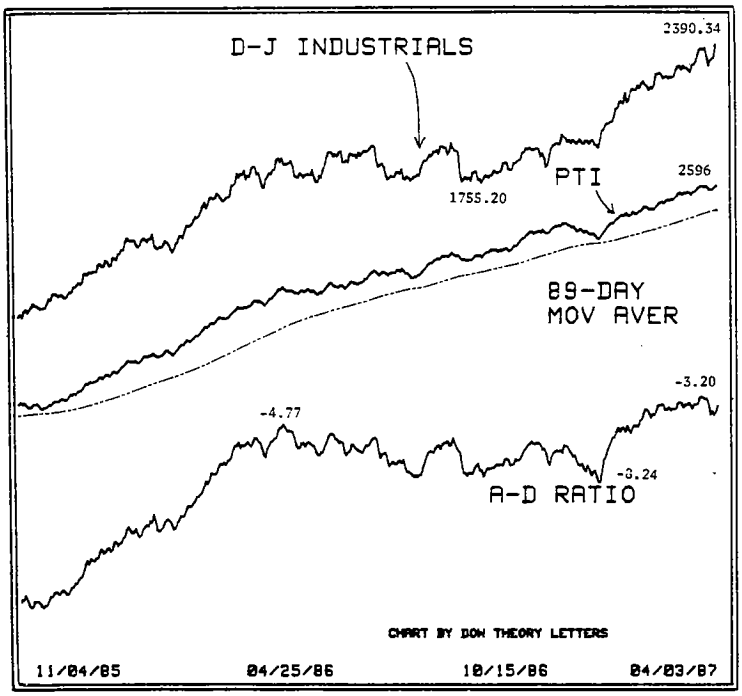
March 27	**DJIA**	**2335.80;**	**PTI 2590;**	**A-D Ratio -3.56**
April 3	**DJIA**	**2390.34;**	**PTI 2596;**	**A-D Ratio -3.68**

Answer: Any fool can run with the crowd. It doesn't take brains to open your mouth when it's raining chocolate kisses. What I'm trying to do in writing these reports is (1) to present the market picture, (2) to report the possibilities and (3) to present various intelligent courses of action. I have advised a gradual process of taking profits as this market climbs higher on the basis of this being (statistically) the most EXPENSIVE market I have ever seen.

In the current issue of Barron's (April 6) there is an interesting interview with four market professionals. All four expect higher prices, but in reading the piece you will note that Marty Zweig has many of the same misgivings about this market that I do. At one point in the interview Marty states, "We're in a transition from bull to bear, and it takes a while. Sometimes it takes a year, a year and a half. It's exasperating. Personally, I hate this market. I look at the P/Es and the yields, and I think the world is sick. But you've got to be patient too. I'll probably be underinvested for a while."

I know exactly what Marty is thinking, and I know exactly why he "hates" this market. Marty has been around long enough to know that ultimately overpriced markets punish participants for their greed, and the punishment invariably comes in the form of losses, usually severe losses. Marty knows that on the basis of history one should EXIT from a market in which the Dow is selling at 20.7 times earnings while yielding 2.8%. Yet the market is still going up, it "looks" like it wants to go a lot higher, and he desn't want to look like a fool if the advance continues (neither, by the way, do I). Marty and I both know that clients HATE an advisor who turns bearish TOO SOON. Careening markets feed on people's greed, and who wants to listen to an advisor who is advising caution, when money and profits are swirling around like leaves in a fall breeze.





Question: Russell, almost every newsletter I read seems to have its own particular target for the Dow. One says "Dow 3000 by 1990," another says "3600 by 1989," a third says "2500 by the end of this year." Do these predictions make any sense?

Answer: In my opinion, they don't. But they make for good reading and good publicity. And they do serve one purpose. I've always said that investors will accept any brand of bunk, any prediction, any promise -- rather than take the pain of UNCERTAINTY. In fact, many otherwise intelligent investors will pounce on a prediction rather than mull over a few intelligent probabilities. Yet veteran investors know that the only thing we can deal with in the stock market is probabilities.

A stock market analyst's work is much like a surgeon's work. When a surgeon removes a cancer there is no way he can guarantee that the patient will live five years, 20 years or that he will even survive the operation. The surgeon offers his expertise and his experience, his intuition, his record and the history of such operations -- and he comes up with a statement based on the probabilities. That's all the surgeon can honestly offer. If he offers a guarantee, then we know that the surgeon is a charlatan.

It's the same thing with stock market analysts. The analyst may see the Utility Average topping out or the A-D lagging -- and he offers his opinion. He presents the possibilities and the probabilities, based on history, his experience, and his intution. If he offers any more than that, we know that the analyst is just a publicity-seeker or a financial witch doctor.

One of the basic tenets of the Dow Theory, one that should never be forgotten is this: NEITHER THE DURATION NOR THE EXTENT OF A PRIMARY MOVEMENT CAN BE PREDICTED IN ADVANCE. That statement, if it was adhered to, would save many a market analyst from ultimately looking like a fool. But as I've noted many times before, in this business the advisories come and the advisories go. Unfortunately, many advisories "go under" while taking their readers with them (usually during the advent of a bear market).

Question: If and when a bear market starts, don't you think the utility stocks should be held regardless? Isn't this a very stable industry?

Answer: I don't know how stable or unstable the utility industry is at this point, but the record of the utility stocks is one of huge percentage swings. Mull over these figures: In 1949 the D-J Utility Average started up at a value of 33.36. By 1965 the D-J UA topped out at a bull market high of 163.32 -- a rise of 389%. By 1974 the UA had hit bear market bottom at 57.93 -- a loss of 64%. From the 1974 low the UA rose to a 1987 high of 227.83, a gain of 293%. A rise of 389%, loss of 64%, a rise of 293%; now I'd call those big swings, wouldn't you?

In the last bear market (i.e., 1973-74) the Dow dropped from 1051 to 577, a loss of 45%. During the same period the D-J Utility Average dropped from 120 to 57, a loss of 52%. So despite what most people think, the utilities have been anything but stable over the years. Conclusion: when the bear takes over, sell those utilities!

INVESTMENT POSITION: Our one-horned bull still dominates the box. It's a bull market (according to Dow Theory) until PROVED otherwise, and as of this writing there's been no "proof otherwise." However, I have (as all but my new subscribers know) stopped advising the purchase of common stocks. I have done this on the thesis that stocks are now GROSSLY OVERVALUED and buying overvalued stocks has (if history means anything) consistently led to losses.

Last week I talked with Gerry Weiss ("Investment Quality Trends" in La Jolla), and Gerry has for many years kept careful records of 350 blue-chip NYSE issues. Gerry told me that at the last reading, 37% of her 350 blue-chips were in the "overvalued" zone. This has only occurred once before — at the 1968 top (the nearest comparison to that was the 31% overvalued at the December 1972 top). Just as ominous, only 12% of the 350 blue-chips are now in the "undervalued" zone, and this situation was last seen at the 1968 top (the only worse statistic was the 10% undervalued seen at the 1966 top).

So all in all, I am sticking to my advice of recent Letters which states: "Do no more buying, and continue to take profits. We're in the overvaluation zone where, historically, bear markets have begun."

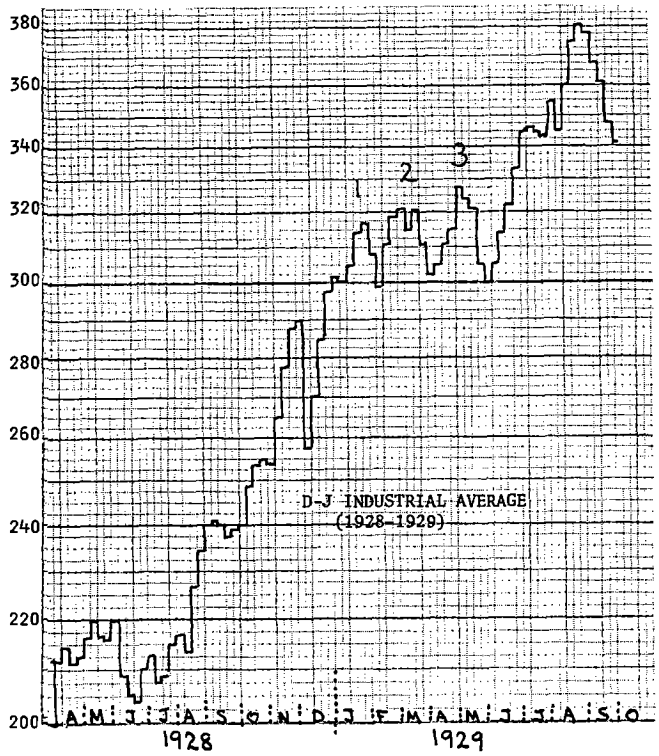
COMPARISONS: Because there has been talk among the bears of 1986-87 resembling 1928-29, I thought it would be interesting to compare the actual price action of the two periods on the charts. I have used weekly closes, and I have drawn the price action to ratio scale, so that the two periods can be properly compared (ratio charts deal in percentages, so that a rise of say 200 to 400 takes up the exact same vertical distance as a rise from 400 to 800 or a rise from 800 to 1600).

The entire advance from the 1921 Dow low of 63.90 to the 1929 Dow high of 381.17 represented an increase of 496%. The rise from the 1974 Dow low of 577.60 to the recent Dow high of 2372.59 represents an advance (so far) of 310%. But it is the price action that I want to examine.

The reason I want to examine the recent price action is that I feel we are now deep in the third (psychological) phase of this bull market. At the top in 1929 the Dow provided a yield of only 3.1%. Today the Dow yield is even less at 2.95%. Thus, on the time-honored test of yields, one could make a case that the Dow today is roughly in the same area that it was in late 1929.

To turn to the price action during the years 1928 and 1929, note that there was a massive rise from June '28 into early 1929. Next, there was that peculiar three-peaked structure during January to June of '29. Then came the final explosive run to the final top, a run that ended on September 3, 1929.

For a comparison, turn to the action of the Dow during 1986 and '87 so far. It may be pure coincidence, but to me it is eerie that we see the same three-peaked structure during 1986. Out of that three-peaked structure came the the roaring advance from late-86 to



the present, a rise that far surpasses (in percentages) the final rise of 1929.

What can we infer from the comparison of the two periods? I'm honestly not sure, although I am fascinated by the three-peaked structures in both periods and the explosive rise following each third peak, a rise that took the Dow to the overvalued 3% yield zone in both cases.

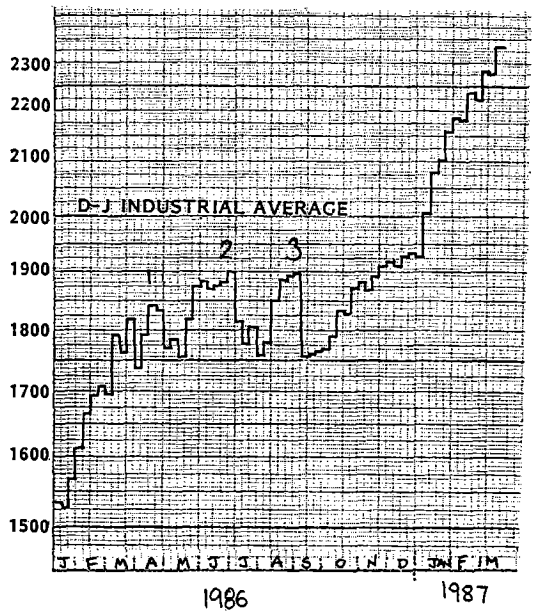
Does the 1929 example imply that following the current market rise, we are fated to experience another horrendous crash? History seldom repeats itself exactly. So I would have to say that I would be surprised if we had even a close copy of the '29 collapse following the end of the current rise. But my instinct does tell me that when the current advance finally does top out, the market could get nasty, very nasty.

Another thought is this: most of the analysts who even dare to talk about an end to the current rise talk in terms of "a correction, and possibly a severe correction." I tend to think that when the current advance is over, we can expect a primary bear market. I note also that everyone who dares to envision trouble is putting that trouble off to 1989 or even to1990. My own thinking is that the trouble might come as soon as this year.

THOUGHTS: In Letter 960 (page 2) I published a chart showing the S&P 500 and its price/dividend ratio going back to 1900, a period of over 85 years. The chart shows that there have been nine times since 1900 when the market was willing to bid stocks up to the point where the S&P 500 sold at 32 or more times its dividends.

The record shows that if you had bought stocks during any of the previous eight periods, you would have ended up losing money. Five of those instances represented major bull market tops. They occurred in 1929, 1937, 1946, 1966, and 1973. The other three instances occurred at secondary tops, prior to important corrections within ongoing bull markets. They appeared in 1933, 1962, and 1968.

All of which brings us to the ninth time that the S&P has sold at better than 32 times its dividends. That time is NOW. So the obvious question is this: Could 1987 be the year when an 87-year-old pattern of market tops is broken? Is there something different about 1987, something that makes the market in 1987



immune from the curse of overvaluation that has broken the market every time in the past when the S&P has sold at 32 or more times its dividends?

My answer is a very dubious maybe. The Dow 3,000 or 4,000 bulls will tell you that "this time it's different." They will tell you that there never was a time before when the rest of the world (particularly the Japanese) was throwing billions of dollars at the US market. They will tell you that the dollar is collapsing, and each tick down in the dollar makes the great companies of the US more attractive to hard currency nations. They will tell you that the Fed knows that the US cannot afford an economic recession, and that the administrations and the Fed will opt for a liquidity-based inflationary boom rather than a deflationary recession. They will tell you that American corporations have grown lean and mean, and that profits are consequently fated to be higher than even the optimists are forecasting. They will tell you that the pension funds and the IRAs and the institutions are compounding and accumulating money at such a furious rate that the stock market "has to go up," based merely on reinvestment by these entities.

All of this presents a fascinating picture to me. Here we have a host of bullish new reasons why history should be denied — reasons all aligned against a value ceiling that has held ever since men first analyzed and invested in the market.

What's the Russell opinion (after all, you don't pay me to read charts; anyone can read charts. You pay me for my opinion)? My opinion is that the equity-gamble from here on isn't worth the candle. In other words, I have found via my own 40 years of experience in the stock market that IN THE MAJORITY OF CASES when you go against probabilities in the market, the odds of winning don't override the odds of loss.

Now understand, I'm not saying that "this time" the S&P can't ultimately sell at 38 or 40 times dividends. I'm simply saying that it's NOT a good bet. It's not a good bet because experience tells us that if you continue to bet against historical probabilities, you're on the road to patched pants and scuffy shoes.

Next thought: How does really conservative big money operate? Let's say you have $5 million in savings. What are you going to do today? Here's one way you might be thinking. The market is expensive here. If I buy a cross section of Dow stocks, I'll get get less than 2.8% on my money, and even that 2.8% is taxable. Bonds have been going up for years, and now inflation may be heating up. Therefore, the odds are that I might not be buying bonds advantageously here. But I can put my $5 million in a muni cash account geared to my own state and get 3.8% free of taxes, which amounts to $190,000 a year. I can live nicely on that, and I won't have to sweat out the stock market or the bond market.

What about inflation? If inflation begins heating up, the bond market will take a swan dive, and I may start nibbling on bonds if that occurs. I can also put say a few hundred thousand into a gold stock fund as an inflation hedge. If deflation or a stock market collapse occurs, I'm in good shape. My muni cash fund will be as safe as anything around.

In other words, at this point, the conservative investor has to be thinking in terms of PRESERVATION of captital. He isn't greedy, he isn't impatient. And he knows something of history. He knows, for instance, that areas of extremely rich values don't last long (or at least they never have). He knows that time is on his side, as far as the next advantageous turn of events is concerned. And he's in that happy state of mind where he really doesn't care what happens. He's living well, he isn't at risk, he's positioned against the consensus opinion, and he's acting on that time-honored adage, "When in doubt — stay out."

"That's fine for a 60-year-old man with $5 million," you retort, "but how about me? I'm 25 and I've only got $10,000 saved. I don't want to put my money in muni cash and just watch the show. I mean big deal -- the muni cash fund pays me $380 a year tax-free. I might as well shoot the works in the stock market, and maybe make some real money. Heck, you know what they say: 'You're young; you can afford to take a risk.' "

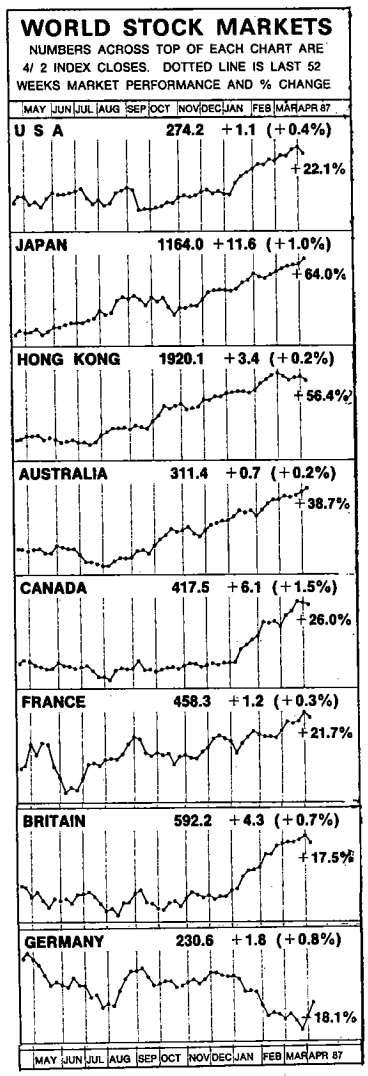
Russell opinion. Totally wrong. Obviously, you lack one thing the guy above has, and that's important money. But you have one thing he can't buy, and that's TIME. You've got 35 years until you're 60. So you've got to decide whether you want to end up in good shape -- or whether you just want to play around with the markets. The crucial thing for you to do is NOT TO LOSE YOUR CAPITAL. The next intelligent thing for you to do is to go for the safest high returns at any given time. That requires discipline, intelligence, and a knowledge of history.

Example: Suppose you buy muni bonds at 6% with your $10,000 and suppose you can (and are able to) reinvest at 6% for the next 35 years. You end up with $76,860. Now suppose you add $2,000 to your muni bond portfolio every year (adding that to your original $10,000). What do you end up with after 35 years at age 60? You end up with $1,079,766. Now that isn't so bad, and all you did was (1) compound at 6% in tax-free bonds, (2) not lose money, (3) stick to a plan, and (4) UTILIZE TIME.

So that's the sure way of making money. Of course there can be variations. For one thing, if stocks go into a bear market and Dow yields climb to say 7% to 9% you can put new money into the Dow stocks on the basis of the Dow being an irresistible bargain. There are, to put it briefly, a lot of things you can do, but the basis of the plan is to (at any given moment) buy value and the safest high return you can find. That's working with time. As opposed to this, speculators are basically trying to BEAT TIME. That's all speculation is -- an attempt to beat time, utilizing information and the trend. And remember this -- beating time is a heck of a lot harder than compounding.

EDSON GOULD: I guess it's a sad coincidence. I haven't mentioned Edson Gould in years, but in the last Letter I referred to his Senti–meter and I included an up–dated picture of the Senti-meter. Then a few days later I heard that my friend, Edson Gould, had died. Gould was a pioneering market analyst. He discovered and invented many valuable devices with which we can analyze the market. Some of these devices like the Senti-meter were based on fundamentals (yields) and some were purely technical such as Edson's speedlines.

Gould was a rarity in this business, a total gentleman, a brilliant analyst, and a man who led with his intelligence rather than his ego. Edson and I exchanged reports for many years. I don't think I ever put down a copy of one of his reports without being able to say, "I learned something." Edson lived well into his 80s. That alone is a feat in this business. Rest in peace, Edson, I'll miss you and your writing.


WORLD STOCK MARKETS
NUMBERS ACROSS TOP OF EACH CHART ARE 4/ 2 INDEX CLOSES. DOTTED LINE IS LAST 52 WEEKS MARKET PERFORMANCE AND % CHANGE
MAY JUN JUL AUG SEP OCT NOV DEC JAN FEB MAR APR 87
U S A 274.2 +1.1 (+0.4%) +22.1%
JAPAN 1164.0 +11.6 (+1.0%) +64.0%
HONG KONG 1920.1 +3.4 (+0.2%) +56.4%
AUSTRALIA 311.4 +0.7 (+0.2%) +38.7%
CANADA 417.5 +6.1 (+1.5%) +26.0%
FRANCE 458.3 +1.2 (+0.3%) +21.7%
BRITAIN 592.2 +4.3 (+0.7%) +17.5%
GERMANY 230.6 +1.8 (+0.8%) +18.1%
MAY JUN JUL AUG SEP OCT NOV DEC JAN FEB MAR APR 87

TRENDS: What's the hardest thing to do in this business? In my opinion, the hardest thing to do is to (try to) make sense out of what the markets are telling us. All that notwithstanding, I'm going to try.

We see the stock market, not only in the US, but stock markets throughout the Free World, booming. There's no question about it, what we've been watching is a massive global bull market, and I illustrate this mass action on the charts to the left (courtesy of Investor's Daily).

Undoubtedly, part of the reason for the world boom has been the giant build-up in LIQUIDITY--most of it generated by rising confidence, which in turn has led the way to rising DEBT. On top of that, the world has been feeding off the US's horrendous trade deficit while Americans in turn have been feeding off of their own government's $200-billion annual deficits.

How is all of this financed? Here's the secret: foreigners have been shipping huge quantities of goods to the US while accepting mountains of US dollars in payment. The foreigners then turn around and buy one-third of the US's annual deficits (in the form of US government bills, notes, and bonds) with the dollars they've earned. With the rest, they buy US stocks, bonds, and corporations.

The victim, marketwise, is the US dollar. When a nation won't compete, when it consistently spends more than it makes and when it imports more than it exports -- then its life blood is oozing out. It is hemorrhaging. The symbolic life blood of a nation is its currency. The US's currency is the dollar.

There's a positive side to the dollar slide. The positive side is that the slide tends to make US goods more competitive. But there's also a negative side to the dollar slide. The negative side is that as the dollar declines, foreign dollar investments lose their value. For instance, in terms of yen or marks the dollar's slide has wiped out huge chunks of Japanese and German investment values. How much longer will foreigners continue to buy US stocks or bonds if the dollar continues to head for the cellar? How much longer will they even continue to hold them?

As the dollar slides, the prices of goods (assuming the economy is still holding level or expanding) tend to rise. Obviously the prices of IMPORTED goods will rise as foreign manufacturers seek to hang on to their profits -- to make up for the cheaper dollars they are receiving. And now, the early signs of inflation are beginning to show in the markets.

NOTES & QUOTES: WILD: Two weeks ago at Christy's a Van Gogh painting (valued at maybe $9 million tops) was auctioned off for a record $39.5 million. The art world was staggered. The NY Times art critic was livid at what he termed the overvaluation. ... Last week the jewelry collection of the Duchess of Windsor was put up for sale at a two-day auction in Geneva. The pre-auction estimate was that it would go for $7.4 million. The first-day auction's total -- an incredible $33 million. ... Last week

Faye and I were at San Diego's "Fine Car Store" talking to our friend, Alan Holmes. He had just put an ad in the WSJ to sell his Ferrari Daytonas (he had four of them, and we're talking EXPENSIVE cars). Alan was shaking his head, "I sold three of them today. I've never seen anything like this since I've been in this business! It's incredible." As we were leaving, Alan's phone rang. A minuute later he ran out of the showroom screaming, "I can't believe it. A guy just called up and bought the fourth Daytona!"

Was all of this telling us something? I turned to Faye, "Maybe we should sell the house and the cars and the furniture and move into all-cash."

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Boy, am I a grouch. I can't stand platitudes and "in" expressions. In fact, I publish an occasional list of in-words and expressions that I loathe. So please don't use the following around me. (1) "Driven." This year the market is like a Ford car, it always seems to be driven. Stocks are inflation-driven, earnings-driven, interest-rate driven. Frankly, it's driven me up da wall. (2) "Hands-on." I'm a hands-on guy, I have a hands-on business, I want a hands-on president in the White House. If I get my hands on the guy who made up that expression, I'll ... . (3) "Point in time." Suddenly, every jerk is talking about a point in time. I mean, at this point in time, it's time to figure out why the devil anyone would use point in time instead of simply "at this time."

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FOREIGN NOTES: West Germany, once considered "the engine of Europe," is seeing its economy slow down. The last quarter of '86 showed no growth, and the forecast is that the first quarter of '87 will show an actual drop in industrial production. ... An ad in the men's fashion section of the March 22 NY Times is from China's National Animal By-Products Imp. The ad states that the Chinese company has all kinds of leathers for sale or they will make leather clothes to the manufacturers specifications. Russell prediction: the great Chinese sales and manufacturing push is on. And remember, wages in China are roughly 40 cents an hour. ... Gorbachev wants a Hollywood in Russia, and one major reason is that he wants hard currency. According to an LA Times article, "American executives who've trekked to Russia claim that more progress has been made by the two sides in the last four months than in the last two decades." And the Russians are starved for entertainment instead of propaganda. States Gary Essert, head of Filmex, "Every time an American film is run in the Soviet Union, it doesn't matter if it's the lousiest film ever made, you can't control the crowds. They've put them in 5,000-seat theaters; they know the people will come. The Soviets know if it's an American movie, it's going to be made for entertainment first, and they're starving for that."

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REAL ESTATE REPORT: Prices of land and homes in Japan have gone through the roof. Land prices in Tokyo are 10 times higher than in NYC and 20 to 30 times higher than in LA. Land prices in the center of Tokyo jumped 50% in 1986 from year-earlier prices. And the Tokyo phenomenon is spreading. Some Tokyo workers are now commuting 40 and 50 miles to work. The vacancy ratio in Tokyo is now below 1%. All of which gives you some idea of why the Japanese are paying record-setting prices for US property. No matter what the prices here, the Japanese think it's cheap. ... Meanwhile, in the US, the real estate comparisons are rather startling. The average sales price of a new single-family home in Jan. '86 was $104,100. In Jan. '87 it was $127,100. Average price of an existing single-family home in Jan. '86 was $93,000. In Jan. '87 it was $100,300. I guess you could call that inflation, couldn't you!

I get a kick out of the real estate and apartment ads in the back of the magazine section of the Sunday NY Times. The weekly ads for condos and apartments read as though each unit is a once-in-a-lifetime jewel. Furthermore, the implication is that the potential buyer is blessed to have even discovered the ad. The prices are wild, running as high as $200,000 for well-placed studios and into the millions of dollars for the "better" east-side condos.

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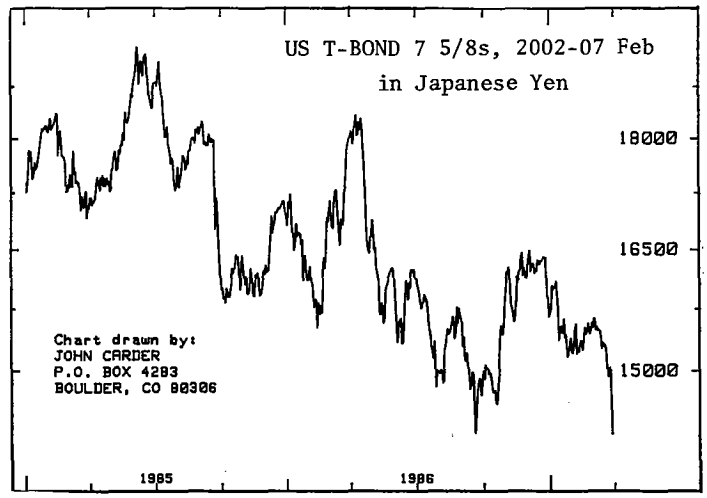
How long will the Japanese (and other hard money nations) continue to buy US Treasury bonds? I asked computer whiz John Carder to draw this chart of a typical T-Bond in terms of Japanese yen. As you can see, the Japanese have taken a terrific pasting on billions of dollars of T-bonds in terms of their own currency. Is it any wonder that the Japanese are praying for a dollar rally?



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San Diego is a sports town with movement. Two years ago real estate tycoon Alex Spanos bought the San Diego Chargers (football) for around $80 million. Then last week Joan Kroc (wife of McDonalds' founder, Ray Kroc) sold the Padres (baseball) to another real estate tycoon, George Argyros, for a reputed $40 to $55 million. Does Argyros like baseball? He must. He already owns the Seattle Mariners (which he now must sell), and in the last six years he's lost $23 million on that team.

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NUMBERS: The Hunts of Texas are in litigation in their struggle to hold off the banks. The Hunts have a $13.8 billion lawsuit going against their bankers. Two of the banks, Manufacturers Hanover and Citicorp, are holding secret talks aimed at settlement. Why? One reason is that it's costing the various banks (get this) $5 to 6 million a MONTH in legal fees to fight the Hunts! And the case isn't due to be heard until next year. ... Ford workers are on strike in Mexico. The pay for the Mexican workers is $24 per week. And you wonder why American manufacturers do it out of town! ... PTL (the former Jimmy and Tammy "religious" show) is trying to borrow $50 million. ... The Vatican, citing "drastically" insufficient revenue and the falling dollar, has projected a record $63 million deficit for 1987, up 12.5% from 1986's estimated $56 million deficit. ... Defense spending will ultimately break the world. World defense spending is now $1 trillion a year or $2 million a minute. Hideous example: Ethiopia. There is one doctor for every 69,000 Ethiopians. It is the world's poorest nation with a per capita income of $110 per year. Yet Ethiopia spends 25% of its annual government budget on arms (on top of that, Russia has poured a total of $3 billion into Ethiopia -- all in arms)! ... Interesting statistic: one US Trident missile submarine costs $2 billion, equal to 25,000 surburban homes worth $80,000 each. ... The Fed estimates that there are 1.3 million millionaires in the US. BUT only 200,000 of them have a salary of $200,000 or more. ... Today only 41% of all US women aged 20 to 24 are married, down from 72% in 1960. Married couples were 78% of all households in 1950 but today they are only 58%.

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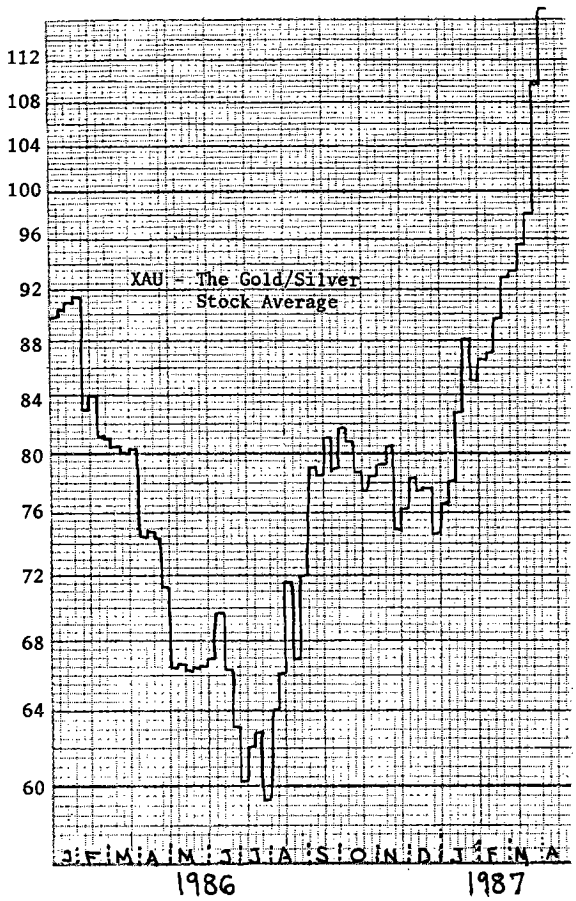
GO FOR IT: Want to get rich? Easy, (1) sell your company to the Japanese, or (2) sell it to the public. Tiffany's, the legendary jewelry store, is doing both. First they sold the 59th St. and Fifth Ave. (NYC) building which houses their store to the Japanese. Then their executives did a leveraged buy out. Next, the execs are going to issue 4 million shares at between $21 and $23 to the lucky public. When the stock is sold, the execs will make roughly $44 million on a total investment of $1 million. And even after the offering, 16 execs will still own 815,000 shares worth around $17 million.

PRECIOUS METALS: "When coming events cast their shadows before, those shadows fall on the New York Stock Exchange." So wrote the great Dow Theorist, William P. Hamilton. Study the accompanying chart of the XAU gold/silver average (the XAU includes such stocks as ASA, Campbell, Dome, Homestake, Hecla, Sunshine, Callahan, and can be punched out on most brokerage machines -- you can also buy options on the XAU). Note that around July of 1986 (following a major slide), perceptions about precious metals and precious metal stocks CHANGED.



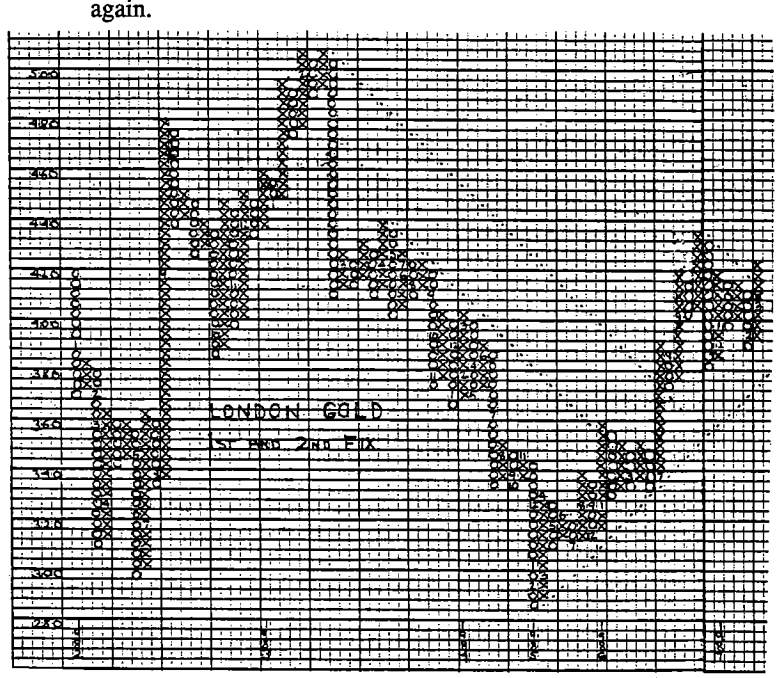
During July the XAU hit a low of 59, and it then started to climb. By September the XAU was above 80. A reaction took place from September to December, but in late-December the XAU began a new advance. By last week the XAU was over 115. This means that the XAU average of gold and silver stocks has almost DOUBLED over the last eight months. During 1987 so far, the XAU has risen 46%.

Why? What's happening? In the last Letter I explained that at $400 dollar gold, the gold mines (at a cost of around $220 an ounce to mine gold) were enjoying a huge markup. In other words, even if gold stands still here -- at $420 per ounce -- mining gold from a legitimate mine is an excellent business. Furthermore (unlike many other businesses) the gold mines can sell ALL the product they produce.

But very obviously, something more is going on. The first perception is that the dollar is still fundamentally weak, and that US industry is having a devil of a time exporting its products. The second perception is that the international credit (banking) structure is tenuous, and that the weak dollar is "a loose cannon on the international ship's deck." The third perception is that the weak dollar could set off a new spate of inflation -- something the Fed might be forced to fight with higher interest rates.

Finally, a few seasoned analysts with a knowledge of history believe that there is only two ways that the world (including, of course, the US) is going to deal with its debts. That path will either be (1) repudiation or (2) inflation. In other words, you either write off the debts or inflate them away. In either event, the island of safety will be GOLD and precious metals. You can't repudiate gold, any more than you can repudiate steel or air or the planet Earth. You can't inflate gold away, you can't destroy it, you can't change it into something else. So farsighted (and worried) people accumulate gold stocks. Those who are even more safety minded or cynical collect the actual gold itself (usually in the form of coins). They do this on the theory that should a world collapse come, the miners could go on strike, the gold stocks could be manipulated or subject to controls, or the exchanges (where the mining stocks are traded) could be closed. But gold coins in one's possession will stand against everything except an actual military defeat or nuclear annihilation.

My point & figure chart of gold is "saying something" worth heeding. With the recent rise to the London fix of 424, gold has given a new bullish signal. A second (and more impressive) bullish signal would come if gold could rally to a London fix of 440. Nevertheless, on the basis of the recent rise to the 424 box, the P & F chart now provides an upside count or target for gold of 480. It would take a decline to 388 to turn gold near-term bearish again.



In Letter 956 (Jan. 14) I recommended Lexington Goldfund as it broke out of its base above $4. I have recommended it repeatedly since, and the fund is now above 6.40. I continue to feel that this is a good (and simple) way to participate in the still-young precious metals bull market. Lexington Goldfund, 800-526-0056. In NJ 800-932-0838.

LATE NOTES: The market is wild and volatile with the Dow pushing to record highs, Utilities lagging, and the Transports confirming above 958.21 as this is written (but not yet on a closing basis). Perhaps the stock market is merely reflecting the hurricane outside.

What hurricane? Hotels in Maui selling to the Japanese for twice their worth, condos in NYC skyrocketing in price, an auction in Geneva with $7 million worth of jewelry going for $50 million, a $5 million van Gogh auctioning for $39.5 million, the XAU gold/silver stock average doubling in nine months, the S&P 500 selling at 34 times dividends for a yield of 2.9%, the Dow droping 57 points, then a few days later rising a record 69 points. Welcome to 1987, "THE YEAR OF THE FINANCIAL FEEDING FRENZY." The bulls say, "Enjoy." The bears admonish, "As ye sow, so shall ye reap." Russell says, "Don't be greedy."

NEXT MAILING: April 22